



MINUTES OF THE FORTY-SECOND ANNUAL MEETING OF THE NORTH CAROLINA REINSURANCE FACILITY HELD AT THE GRANDOVER RESORT AND CONFERENCE CENTER, ONE THOUSAND CLUB ROAD, GREENSBORO, NORTH CAROLINA, OCTOBER 13, 2016

MEMBERS PRESENT

Allstate Insurance Company
 Allstate Indemnity Company
 Allstate Northbrook Indemnity Company
 Allstate Property & Casualty Insurance Company
 Allstate Vehicle and Property Insurance Company
 Encompass Indemnity Company
 Esurance Insurance Company
 Atlantic Casualty Insurance Company
 Little River Insurance Company
 Erie Insurance Company
 Erie Insurance Exchange
 Erie Insurance Company of New York
 Erie Insurance Property & Casualty Company
 Flagship City Insurance Company
 Falls Lake National Insurance Company
 Stonewood Insurance Company
 GEICO Indemnity Company
 Amguard Insurance Company
 Berkshire Hathaway Homestate Insurance Company
 Norguard Insurance Company
 Eastguard Insurance Company
 General Star National Insurance Company
 Government Employees Insurance Company
 Genesis Insurance Company
 National Indemnity Company
 National Liability & Fire Insurance Company
 Pennsylvania Insurance Company
 United States Liability Insurance Company
 GEICO Advantage Insurance Company
 GEICO Casualty Company
 GEICO Secure Insurance Company
 GEICO Choice Insurance Company
 GEICO General Insurance Company
 Hartford Casualty Insurance Company
 Hartford Accident & Indemnity Company
 Hartford Fire Insurance Company

REPRESENTED BY

Fernando Hernandez

Mark Caughron
 Sonja Maki
 Cody Cook

Steve Hartman
 Greg Spray
 Andrea Bradley
 Elaine Sola

Andy Montano

Hartford Insurance Company of the Midwest
Hartford Underwriters Insurance Company
Property & Casualty Insurance Company of Hartford
Sentinel Insurance Company, Ltd.
Trumbull Insurance Company
Twin City Fire Insurance Company
Integon General Insurance Corporation
Agent Alliance Insurance Company
AmTrust Insurance Company of Kansas, Inc.
First Nonprofit Insurance Company
Imperial Fire & Casualty Insurance Company
Integon Casualty Insurance Company
Integon Indemnity Corporation
Integon National Insurance Company
Integon Preferred Insurance Company
Milwaukee Casualty Insurance Company
National General Insurance Company
National General Insurance Online, Inc.
New South Insurance Company
Security National Insurance Company
Sequoia Insurance Company
Technology Insurance Company
Tower Insurance Company of New York
Wesco Insurance Company
Liberty Mutual Insurance Company
American Economy Insurance Company
American Fire & Casualty Company
American States Insurance Company
American States Preferred Insurance Company
Colorado Casualty Insurance Company
Employers Insurance Company of Wausau
Excelsior Insurance Company
First Liberty Insurance Corporation
First National Insurance Company of America
General Insurance Company of America
Liberty Insurance Corporation
Liberty Insurance Underwriters, Inc.
Liberty Mutual Fire Insurance Company
Liberty Mutual Mid-Atlantic Insurance Company
LM General Insurance Company
LM Insurance Corporation
LM Property & Casualty Insurance Company
Midwestern Indemnity Company
Montgomery Mutual Insurance Company
Netherlands Insurance Company
Ohio Casualty Insurance Company
Ohio Security Insurance Company
Peerless Indemnity Insurance Company
Peerless Insurance Company
Safeco Insurance Company of America
Safeco Insurance Company of Indiana
Wausau Business Insurance Company

Art Lyon
Brian Rogers

Michele Lapinski

| | |
|--|------------------|
| Wausau Underwriters Insurance Company | |
| West American Insurance Company | |
| Nationwide Mutual Insurance Company | Joel Buck |
| Allied Insurance Company of America | Terry Collins |
| Allied Property & Casualty Insurance Company | Mendi Riddle |
| AMCO Insurance Company | Tom Souder |
| Crestbrook Insurance Company | |
| Depositors Insurance Company | |
| Farmland Mutual Insurance Company | |
| Freedom Specialty Insurance Company | |
| Harleysville Mutual Insurance Company | |
| Harleysville Preferred Insurance Company | |
| Harleysville Worcester Insurance Company | |
| National Casualty Company | |
| Nationwide Affinity Insurance Company of America | |
| Nationwide Agribusiness Insurance Company | |
| Nationwide General Insurance Company | |
| Nationwide Insurance Company of America | |
| Nationwide Mutual Fire Insurance Company | |
| Nationwide Property & Casualty Insurance Company | |
| Scottsdale Indemnity Company | |
| Titan Indemnity Company | |
| Victoria Automobile Insurance Company | |
| Victoria Fire & Casualty Company | |
| Pennsylvania National Mutual Casualty Ins. Company | Lynette Prosser |
| Penn National Security Company | |
| Permanent General Assurance Corporation of Ohio | Sondra Cavanaugh |
| American Family Mutual Insurance Company | |
| American Standard Insurance Company of Wisconsin | |
| Midvale Indemnity Company | |
| Sentry Insurance A Mutual Company | Peter Sampson |
| Dairyland Insurance Company | |
| Middlesex Insurance Company | |
| Peak Property & Casualty Insurance Corporation | |
| Sentry Casualty Company | |
| Sentry Select Insurance Company | |
| State Farm Mutual Automobile Insurance Company | Alan Bentley |
| Travelers Indemnity Company | Molly Dunn |
| Automobile Insurance Company of Hartford | |
| Charter Oak Fire Insurance Company | |
| Commercial Guaranty Insurance Company | |
| Discover Property & Casualty Insurance Company | |
| Fidelity & Guaranty Insurance Company | |
| Fidelity & Guaranty Insurance Underwriters, Inc. | |
| Farmington Casualty Company | |
| Northland Casualty Company | |
| Northland Insurance Company | |
| Phoenix Insurance Company | |
| Select Insurance Company | |
| St. Paul Fire & Marine Insurance Company | |
| St. Paul Guardian Insurance Company | |
| St. Paul Mercury Insurance Company | |

| | |
|---|----------------|
| St. Paul Protective Insurance Company | |
| Standard Fire Insurance Company | |
| Travco Insurance Company | |
| Travelers Casualty & Surety Company | |
| Travelers Casualty & Surety Company of America | |
| Travelers Casualty Company | |
| Travelers Casualty Company of Connecticut | |
| Travelers Casualty Insurance Company of America | |
| Travelers Commercial Casualty Company | |
| Travelers Commercial Insurance Company | |
| Travelers Constitution State Insurance Company | |
| Travelers Casualty & Surety Company of America | |
| Travelers Home & Marine Insurance Company | |
| Travelers Indemnity Company of America | |
| Travelers Indemnity Company of Connecticut | |
| Travelers Personal Insurance Company | |
| Travelers Personal Security Insurance Company | |
| Travelers Property Casualty Company of America | |
| Travelers Property Casualty Insurance Company | |
| United States Fidelity & Guaranty Company | |
| USAA Casualty Insurance Company | Dan Pickens |
| Garrison Property & Casualty Insurance Company | |
| USAA General Indemnity Company United Services Automobile Association | |
| Unitrin Auto & Home Insurance Company | Ed Speich |
| Merastar Insurance Company | |
| Response Worldwide Insurance Company | |
| Unitrin Safeguard Insurance Company | |
| Unitrin Direct Property & Casualty Company | |
| Universal Insurance Company | Jim McCafferty |
| The Members Insurance Company | |

OTHERS PRESENT

Young, Moore and Henderson

North Carolina Department of Insurance

Insurance Services Organization

Wellington Management

Able Auto Insurance

Green & Wooten Insurance

Pinehurst Insurance

Senn Dunn Marsh & Roland

Public Members – NCRF Board of Governors

Staff

REPRESENTED BY

Robert Paschal

Glenn Raynor

Mickey Spivey

Mike Strickland

Fred Fuller

Robert Mack

Dave Cummings

Rob Curry

Chris Holleman

Eric Tanaka

Jeff Butler

John E. Wooten, III

Rob McVay

Tim Ward

Steve Smith

Jannet Barnes

Joanna Biliouris

Edith Davis

Linda Davis
Ray Evans
Vicki Godbold
Keri Johnson
Donna Kallianos
Laura Lee Longest
Frank Lonnett
Tim Lucas
Mike Newton
Karen Ott
David Sink
Rebecca Williams

One-hundred and twenty-nine (143) other companies were represented by proxy.

The meeting convened as scheduled, Mr. McCafferty presiding. Ms. Davis announced that there was a quorum.

Reference was made to the Facility's Antitrust Compliance Policy, Conflicts of Interest Statement, and Code of Ethics and Standard of Conduct Statements, copies of which were included in the materials provided. Mr. Spivey briefly commented on the importance of these guidelines.

1. Minutes of the last meeting

There were no outstanding minutes to be approved.

2. Plan of Operation Amendment

Ms. Davis directed attention to an exhibit distributed in the meeting materials regarding proposed revisions to the Facility's Plan of Operation, Article XV Hearings. She noted that the Facility's Board of Governors had previously approved these revisions on September 27, 2016, and that upon member company approval these proposed revisions would be filed with the Commissioner of Insurance for final approval.

A motion was made, seconded, and unanimously passed to adopt the amendment to Article XV in the Facility's Plan of Operation.

3. Annual Report

Copies of the Forty-Third Annual Report for the fiscal year ended September 30, 2016 were distributed, a copy of which is attached and forms a part of the record. The members were also advised that the Report would be available on the Facility website under its own link from the homepage. Mr. Evans offered general observations from the past year and reported on progress made towards the current year's goals, highlighting the focus on managing members' equity.

4. Chairman's Comments

Mr. McCafferty shared comments on the numerous activities and events of the preceding year, especially noting the activity regarding the continued decline of members' equity balances and the associated implementation of a private passenger loss recoupment; the input provided in the development of commercial auto rate. He recognized Ray Evans for his continued leadership, as well as the Board, the various participating committees, staff, and counsel for their efforts on behalf of the Facility.

5. Adjournment

There being no further business, the meeting was adjourned.

Respectfully submitted,

Edith Davis

Chief Operating Officer

North Carolina Reinsurance Facility

ETD/lad

Enclosure

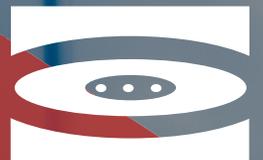
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2016 ANNUAL REPORT

NCRF

NORTH CAROLINA
REINSURANCE FACILITY



REINSURANCE FACILITY

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 Tim Lucas Manager, Automobile
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 Mike Newton. Manager, Claims
 919-582-1018 rmn@ncrb.org
 David Sink Chief Financial Officer
 919-582-1012 des@ncrb.org
 Vicki Godbold Chief Human Resources Officer
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 919-582-1057 src@ncrb.org

2016 ANNUAL MEETING

The annual meeting for member companies of the North Carolina Reinsurance Facility will be held October 13, 2016, at the Grandover Resort and Conference Center, Greensboro, North Carolina.



GENERAL MANAGER'S REPORT



Ray Evans
GENERAL MANAGER

I read somewhere that, “There is no such thing as ready; there is only willing.” We spend a considerable amount of time planning and preparing strategies, but it seems, in the end, while we do our best to be ready, we also have to be willing to change directions to react to events as they unfold. The story of the last year is a good example of this flexibility.

The Reinsurance Facility is unique within the country’s auto residual market. In past years, we have reported that the Facility has the majority of the auto residual market premium in the country, and that hasn’t changed.

In fact, for the latest available year’s data, the Facility has about 75% of the premium for that market. We have cautioned that this alone is not the whole story. The North Carolina uninsured motorist rate is low; every driver has access to insurance coverage, many willing carriers write auto insurance and the percentage of business in the Facility has remained pretty constant over a 40-year period. In the last year or so, this picture has begun to change. To be sure, the Facility continues to have the lion’s share of the countrywide residual market, but it now also has a near historical high percentage of North Carolina auto liability premiums, approaching 30%. Several factors contribute to this change, including the declining cost of gasoline in the U.S., which has increased the miles driven and correspondingly increased claims, and member carriers are ceding more policies.

That carriers are ceding more business is not really a problem, except much of this business, by design, generates significant losses, and the Facility is now incurring losses of approximately \$10,000,000 per month. As a result, staff and a number of Facility committees and task forces have been laboring over solutions. Some avenues available to the Facility are in the form of surcharges. Before these can be used, data has to be accumulated to support any action, and, as the losses have been recent, data has been slow to catch up, so these changes just became effective in October 2016, and the operating results should improve shortly thereafter.

Another example of our willingness is our response to a growing problem with insureds with questionable North Carolina residency seeking commercial auto policies. The Facility’s book of commercial auto liability policies is only about 10% of ceded premium. However, it does present us with considerable exposure and potential volatility as the number of risks is relatively low. The industry saw similar issues with personal auto policies a few years ago, illustrated by a series of New York television reports focused in New York neighborhoods where many vehicles displayed North Carolina license plates. The problem was rectified by changes in the North Carolina private passenger eligibility and rate evasion statutes. Truckers and bus companies could now be taking similar advantage of loopholes in the law. The Facility, in collaboration with the Department of Insurance, the Secretary of State, the Department of Motor Vehicles, the Federal Motor Carrier Safety Administration enforcement folks and a number of member carriers, was able to suggest a legislative fix which became part of the 2016 Legislative short session DOI agency bill and has been enacted. The Facility’s part in this action was providing a place for this group to meet, scheduling and facilitating meetings, researching details for every discussion and helping to craft the legislation, all a part of being “willing” to resolve a problem.

While we might not be ready for every eventuality, by diligently preparing and always trying to be better, and by having associates, Board of Governor members, committee members, carriers and other external resources willing to tackle any problem, the Facility has been able both to comply with our governing statutes and respond to a whole range of events in an effective manner.

MESSAGE FROM THE CHAIRMAN

“Really busy” has become the new normal. Over the past year, the Facility has been involved in many different types of initiatives and has made every attempt to provide innovative solutions to various issues. It has also been a year of great collaboration.

Listed below are some of the highlights for the year:

- The Facility hosted forums designed to assist the Commissioner of Insurance and solicit input into the development of statutory language, which became part of House Bill 287 to address commercial auto rate evasion.
- The Facility provided input related to modifications to House Bill 148 – Insurance Required for Mopeds.
- Personal Auto program changes included the adoption of a Transportation Network Company (TNC) mandatory exclusion endorsement and a new limited TNC coverage program.
- Commercial Auto program changes included amendments to the Facility Commercial Auto Manual rules to address the rating of out-of-state risks and the development of out-of-state base rates to simplify the rating of these risks.
- A loss recoupment was implemented for private passenger policies to address a deficit in members’ equity resulting from deteriorating private passenger experience.
- The deployment of EDGE system changes allowed clean risk and loss recoupment surcharges on private passenger policies to be reported to the Facility on a combined basis, resulting in programming cost savings for the member companies.
- Cession volume, premiums and paid losses continued to increase over the same periods for the prior year. Private passenger policies-in-force continued to steadily increase while commercial auto policies declined significantly.
- 2015 operating expenses were less than the annual budget for the same period and were followed by another decrease in the operating budget for 2016 over the prior year. The operating expenses continue to be less than 1% of the Facility annual premium.
- Our investment portfolio continued to outperform the benchmark despite the decline in account balance resulting from the distributions necessitated by net operating losses.
- A new independent audit firm was engaged for the 2014-2015 fiscal year audit after several decades with another firm.

The world is changing at a more rapid pace than ever before, and it is our responsibility to respond accordingly. This ability to respond requires engagement and support from staff, counsel, the Board of Governors and the committee members who met numerous times in the past year to address these important issues, and they delivered. It has been a privilege to serve as Chair for these past two years and work with these folks.

Jim McCafferty
Universal Insurance Company
Chairman

BOARD OF GOVERNORS

Responsibility for management is vested in a 15-member Board of Governors. The Board includes 12 voting members, seven member insurance companies and five agents appointed by the Insurance Commissioner; two nonvoting public members appointed by the Governor and the Insurance Commissioner, who is a member of the Board ex-officio without vote. Eight meetings of the Board were held during the year, including four telephone conferences.

| Agent Members | Representative |
|---|----------------------|
| Apptd. by the Commissioner of Insurance | W. Hutson Wester, II |
| Apptd. by the Commissioner of Insurance | John E. Wooten, III |
| Auto Insurance Agents of North Carolina | Jeffrey W. Butler |
| Independent Insurance Agents of NC | Robert M. McVay |
| Independent Insurance Agents of NC | Tim Ward |

| Members | Representative |
|--------------------------------|--------------------|
| Allstate Insurance Co | Fernando Hernandez |
| Atlantic Casualty Insurance Co | Robbie Strickland |
| GEICO Indemnity Co | Andrea Bradley |
| Integon Indemnity Corporation | Art Lyon |
| Nationwide Mutual Insurance Co | Mendi Riddle |
| Travelers Indemnity Co | Molly Dunn |
| Universal Insurance Co* | Jim McCafferty |

| Public Members |
|--------------------------------|
| J. David Walker, Lumberton, NC |
| Steven Smith, Raleigh, NC |

| Ex-officio Member |
|--|
| Wayne Goodwin, Commissioner of Insurance |

STANDING ADVISORY COMMITTEES

The Plan of Operation establishes a number of advisory committees. These committees oversee the activities of the Facility and formulate recommendations for presentation to the Board of Governors. In addition, several other specialty advisory groups perform similar tasks for the Facility throughout the year.

Task Force on Expense Allowances

| Members | Representative |
|-------------------------------------|--------------------|
| Allstate Insurance Co | Fernando Hernandez |
| Nationwide Mutual Insurance Co* | Terry Collins |
| Sentry Insurance A Mutual Co | Peter Sampson |
| State Farm Mutual Automobile Ins Co | Alan Bentley |
| Agent | Tim Ward |

Task Force on Recoupment

| Members | Representative |
|--------------------------------------|-------------------|
| Integon Indemnity Corporation | Art Lyon |
| Nationwide Mutual Insurance Co | Terry Collins |
| NC Farm Bureau Mutual Insurance Co | Roger N. Batdorff |
| Progressive Casualty Insurance Co | Kevin McGee |
| Southern Guaranty Insurance Co | Stephen H. Cone |
| State Farm Mutual Automobile Ins Co* | Alan Bentley |
| Agent | Robert M. McVay |

Audit Committee

| Members | Representative |
|--------------------------------------|-------------------|
| Liberty Mutual Insurance Co* | Judi Gonsalves |
| NC Farm Bureau Mutual Insurance Co | Brian Top |
| Nationwide Mutual Insurance Co | Greg Kilburn |
| Pennsylvania Nat Mut Casualty Ins Co | Charles J. Uckele |
| State Farm Mutual Automobile Ins Co | Alan Bentley |
| Travelers Indemnity Co | Jennifer Baurle |
| Agent | Robert M. McVay |

Investment Committee

| Members | Representative |
|-------------------------------------|----------------|
| Allstate Insurance Co | Ronald Pullie |
| Nationwide Mutual Insurance Co* | Joel Buck |
| State Farm Mutual Automobile Ins Co | Robert Stephan |

Rating Committee

| Members | Representative |
|------------------------------------|-------------------|
| Atlantic Casualty Insurance Co* | Mark Caughron |
| Integon Indemnity Corporation | Brian Rogers |
| Nationwide Mutual Insurance Co | David Edwards |
| NC Farm Bureau Mutual Insurance Co | Roger N. Batdorff |
| Travelers Indemnity Co | Edward A. Bosk |
| Agent | Tim Ward |

* Chair

MANAGEMENT REPORT

INTRODUCTION

Several significant shifts in the Facility have occurred in recent years. First, the Facility has grown from 24% to 28% of statewide written liability premium between 2010 and 2015. Revenue exceeded \$1 billion dollars in 2015—and yet the Facility lost money. The details, and how the Facility has responded, are included in this report.

OPERATING RESULTS

Managing members' equity effectively is one of our highest priorities. During the past year, the combined members' equity balance decreased from -\$69.9 million to -\$196.5 million. Both staff and committees monitor the changes in these balances very closely, and appropriate action is taken under the oversight of the Board of Governors and within the guidelines outlined in the general statutes.

After several years of fairly stable results, the commercial auto experience began to turn negative in 2010, with the pace of losses increasing in recent years. Twenty-two of the past 26 quarters have seen operating losses posted for this line, eroding a surplus of \$52 million to a deficit of \$42 million as of June 2016. The Facility has responded to this in numerous ways. More details on these responses can be found throughout the remainder of the report, but the highlights are summarized here.

Annual rate reviews have resulted in several rate increases and, following two double-digit rate increases effective in 2015, the Facility filed for another significant increase to become effective for policies issued on or after October 1, 2016. Cession volume for commercial business declined 10% in 2015 over the prior year, likely a byproduct of the rate increases. As premium volume drops and losses from prior periods get settled, it is anticipated that operating losses will continue for some period to come.

To address the growing number of out-of-state commercial risks applying for North Carolina insurance policies, Commissioner of Insurance Wayne Goodwin requested the assistance of the Facility to develop a proposal for

legislative changes that would prevent companies from other states, attracted by North Carolina's low auto rates, from obtaining coverage and/or lower rates than the out-of-state rates they should be paying. The result was a consortium of state and federal agencies, organizations and members of the industry collaborating toward this common goal while trying to ensure that no legitimate North Carolina business was adversely impacted in the process. During the 2016 session of the General Assembly, the Department of Insurance sponsored House Bill 287, which contained provisions for commercial auto rate evasion reform (more information can be found under *Legislative Changes*). In addition, the Facility revised several manual rules for the rating of out-of-state risks and developed and filed a program for out-of-state base rates to simplify the rating process for the North Carolina carriers. See *Rules, Rates and Forms* for more details.

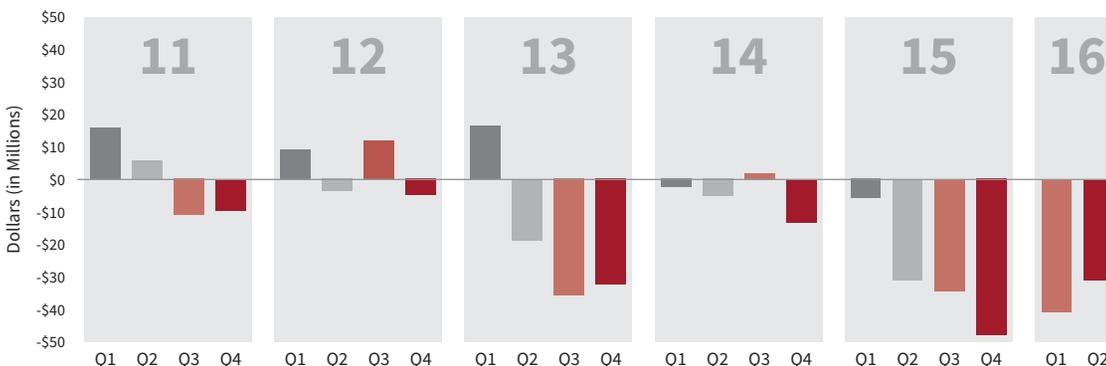
With respect to private passenger business, there are some similarities and some notable differences. As noted in previous reports, Facility operating losses in 2013 were orchestrated by implementing less than the full indications for clean risk recoupment and were designed to reduce the private passenger members' equity surplus of approximately \$84 million. The surplus was reduced as planned but, at about this same time, the experience worsened, and the clean risk recoupment was insufficient to cover the losses.

In mid-2014, gas prices began to drop significantly, and remain low today. The market has seen an increase in miles driven, likely generated by this reduction, and a corresponding increase in claims. As a result, the private passenger experience has been deteriorating since late 2014. Compounding this effect was the increase in cession volume for private passenger policies and specifically of "clean risks" who, by law, may not be charged more than the voluntary rate. There has been no rate increase for these risks in several years. The clean risk recoupment surcharge has returned to the full indication but is based



Edith Davis
CHIEF OPERATING OFFICER

NET RESULTS OF OPERATIONS (AFTER RECOUPMENTS)



on 2014 experience, and through March 2016, operating losses generated a members' equity deficit of \$113 million. As a result, the Facility was forced to implement a loss recoupment surcharge to become effective in October 2016. Details on this are located under *Recoupment*.

While the implementation of the loss recoupment for the private passenger deficit follows the statutory guidelines for the recovery of such a loss, this action is very infrequent; it has been 12 years since the last loss recoupment. This measure is also temporary in nature and will be discontinued once the Facility private passenger losses are recovered.

VOLUME

During this report period, the North Carolina Reinsurance Facility was the largest residual market mechanism for automobile insurance in the United States. The Facility provides reinsurance for approximately one-quarter of the automobile liability business written in North Carolina. While this figure has remained notably stable since the Facility was created in 1973, as illustrated in a chart above, the market share has increased in each of the last five years.

Of the total ceded exposures during this fiscal period, 76% were private passenger "clean risks," and 21% were private passenger "other-than-clean" risks, consistent with the previous fiscal year. The remaining 3% of ceded exposures were commercial auto risks.

As of May 2016, approximately 1.3 million policies were in force—97% were private passenger non-fleet policies, and 3% were all other policies—generating over 30 million transactions annually. Overall, total cession notice volume is about 1.5% higher than for the same period last year, but calendar year 2015 was up 4.2% over calendar year 2014.

Finally, written premium for the fiscal year ending September 2016 is projected to exceed \$960 million, which is approximately 4% higher than the previous fiscal year.

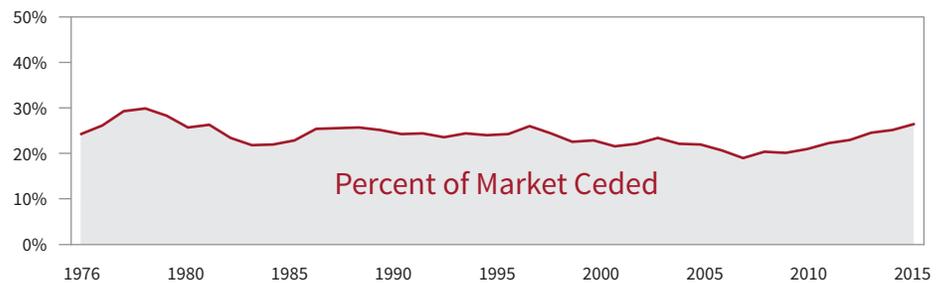
RATES, RULES AND FORMS

Personal Auto Program Changes

Effective March 1, 2016:

The Facility filed private passenger auto rate level adjustments of 1.15% for liability coverages for "other-than-clean" risks and 1.11% for clean risks ceded to the Facility as a result of House Bill 97 – Appropriations Act

SHARE OF NC AUTO LIABILITY MARKET CEDED – BY CALENDAR YEAR



of 2015, in which a new tax was implemented on automobile repair labor and fees were increased for Motor Vehicle Reports (MVRs) and salvage titles.

Effective October 1, 2016:

For "other-than-clean" private passenger risks, the Facility filed a +6.2% rate increase over the rates previously in effect.

For all ceded private passenger risks, changes were also made to the class plan factors and territory relativities.

In October 2015, the Facility adopted two revisions to the NCRF Standard Practice Manual. Recognizing that many companies now use MVR monitoring services, the first amendment to the underwriting requirements removed the term MVR and replaced it with "records of convictions for moving traffic violations," identical to the language used in N.C.G.S. 58-36-65(e) and the North Carolina Rate Bureau Personal Automobile Manual. The second amendment clarified that, with respect to policy files requested for audit, companies must provide a Motor Vehicle Report (MVR) for all operators of the vehicles insured under each ceded policy subject to rating under the Safe Driver Insurance Plan.

The Facility also adopted revisions to the Personal Auto Manual Rule 5 – Safe Driver Insurance Plan (SDIP) to comply with the provisions of House Bill 259, which amended the property damage accident thresholds for private passenger auto.

In addition, the Reinsurance Facility adopted revisions to the North Carolina Personal Auto Policy Program to recognize the operation of Transportation Network Companies (TNC). These revisions clarified that the public or livery conveyance exclusion in the Personal Auto Policy applies while a driver is logged into a TNC application and are incorporated into

a mandatory endorsement to be used with the Personal Auto Policy effective May 1, 2016.

The Reinsurance Facility also introduced an amendment to the Personal Auto Policy Program to allow cession of the drivers of the TNCs. The new Personal Auto Manual rule and endorsement offered limited Transportation Network Driver coverage when no passenger is in the vehicle for use with the Personal Auto Policy in the Facility. Coverage for drivers providing services for TNCs is optional; companies are not required by law to provide such coverage.

Commercial Auto Program Changes

For commercial auto risks, the Facility filed revised basic limits liability rates for trucks, tractors and trailers and private passenger types not eligible for rating under the North Carolina Personal Automobile Manual and revised bodily injury and property damage increased limits factors for those coverages and for garages. The rate level for garages was not revised. Reflecting the significant deterioration in commercial loss experience, the various rate level changes in this filing averaged +24.5% over the rates previously in effect.

The Reinsurance Facility introduced several revisions approved by the Commissioner of Insurance to the North Carolina Reinsurance Facility Commercial Automobile Manual. Rule 8 – Additional Premium Changes was revised to allow companies to use the rates in effect at the time an additional vehicle is added or the rates in effect at the inception of the policy. Rule 12 – Private Passenger Types revised the definition of private passenger auto to track the definition in the Personal Auto Manual. Both became effective immediately.

Two additional revisions were introduced at the same time. Rule 32 – Premium Development – Other Than Zone Rated Autos under the Trucks, Tractors and Trailers Section

and Rule 42 – Premium Developmen – Other Than Zone Rated Autos under the Public Transportation Section were revised to clarify the rating for vehicles that are principally garaged or principally operated in a state other than North Carolina and provided new out-of-state base rates for these risks. These changes became effective on October 1, 2016.

Recoupment

North Carolina law allows carriers to cede to the Facility any eligible risks. While the Facility establishes actuarially sound rates for “other-than-clean” risks (except that no profit is included), the rates for “clean risks” are statutorily capped at the voluntary rate level, which is inadequate to pay the losses and expenses of the clean risks ceded to the Facility. The shortfall between what this group pays and what it should pay is made up through the statutorily authorized clean risk recoupment surcharge applied to the liability premiums of all private passenger non-fleet policies.

Recoupment surcharges are reviewed at least annually and adjusted as deemed appropriate and necessary. In June 2015, the Board of Governors implemented a clean risk recoupment surcharge of 4.06% (before inclusion of agent compensation), applicable to all new and renewal private passenger policies becoming effective on and after October 1, 2015, through September 30, 2016.

In June 2016, the Board of Governors authorized a new clean risk recoupment surcharge of 4.94% (before inclusion of agent compensation), which will be applicable to all new and renewal private passenger policies becoming effective on and after October 1, 2016, through March 31, 2017. For the current fiscal year through June 2016, income from clean risk surcharges has generated approximately \$101.5 million.

North Carolina law also allows the Facility to recoup operating losses. In June 2016, the Board of Governors authorized a new loss recoupment surcharge of 3.32% (before inclusion of agent compensation), which will be applicable to all new and renewal private passenger policies becoming effective on and after October 1, 2016, through March 31, 2017. This recoupment will be adjusted at that time and continued as needed to recover the private passenger members’ equity deficit, which was \$113 million at March 31, 2016.

To simplify the programming requirements for the member companies, the Facility modified its operating system to allow companies to report the clean risk and loss recoupments on a combined basis, saving expense and effort for all private passenger carriers in the state.

COMPLIANCE ACTIVITY

Our compliance staff’s focus is on compliance with statutes, rules and regulations, as well as eligibility for ceded coverage and reimbursement,

as part of our responsibility to ensure that the Facility collects the right premium and pays the right losses. In the various types of audits performed by the compliance staff, member company files are reviewed for, among other items, proper reporting of premiums and losses, claims handling, proper application of underwriting rules, eligibility, experience modification rating and recoupment. The compliance staff also performs audits on non-ceding companies to ensure that recoupment amounts are correctly determined and collected.

New EDGE system data collection functionality for recording audits, under development last year, was deployed in October 2015. Enhancements are planned for late 2016 and 2017.

LEGISLATIVE CHANGES

The Facility was created by the Legislature in 1973 and replaced an Assigned Risk Auto Plan. At that time, there was a perceived stigma of being included in a bad risk pool, so this new mechanism enabled drivers to select the company of their choice. The legislature has made alterations over time to address changing conditions in the marketplace.

The Facility is often asked to provide information to various groups that wish to study these complex matters. While we do not lobby for any one position, we are more than happy to be included in the discussion and to contribute suggestions that, it is hoped, lead to more complete solutions with the fewest unintended consequences. There were two significant bills of interest enacted during the 2016 session.

House Bill 287 – Amend Insurance Laws, sponsored by the Department of Insurance, contained significant new anti-fraud provisions becoming effective December 1, 2016, amending the rate evasion and Reinsurance Facility statutes to address out-of-state risks fraudulently obtaining North Carolina insurance. Key points of the bill add new criminal penalties, provide guidelines for acceptable documentation to prove North Carolina residency for the purpose of obtaining insurance and create a right of recovery for the carriers from insureds who misrepresent their eligibility status when obtaining insurance.

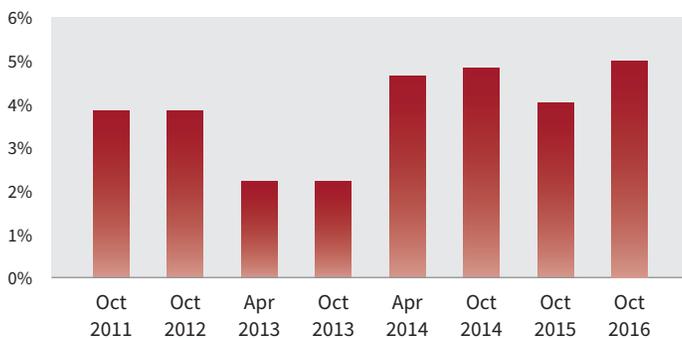
House Bill 959 – DOT Proposed Legislative Changes included provisions that modified legislation passed in 2015 (House Bill 148 then) that had required moped operators to have liability insurance by July 1, 2016, specifically excluded that coverage from being eligible for cession to the Facility and removed moped coverage from the jurisdiction of the North Carolina Rate Bureau. House Bill 959 modified that law, effective July 1, 2016, to maintain jurisdiction for moped liability coverage under the Rate Bureau (but not for physical damage insurance) and to allow mopeds to continue to be ceded to the Facility.

CONCLUSION

During the fast and furious activity that was this past year, we made every attempt to be engaged, helpful and most of all responsive while addressing many significant developments within the industry. Our staff, vendors and counsel were all creative, collaborative and diligent as we developed new and innovative programs, products and processes in addition to our regular work of managing the Facility. And we received nothing short of tremendous support and encouragement from our committees and Board of Governors on all of these efforts.

Edith Davis
Chief Operating Officer

CLEAN RISK RECOUPMENT SURCHARGES



SHARED SERVICES

FINANCE



David Sink
CHIEF FINANCIAL OFFICER

Investments

Net operating losses over the past year have continued to necessitate distributions from the Facility's investment account to satisfy its obligations to member companies. Those distributions have contributed to the decrease in the Facility's book value of its portfolio from approximately \$770 million to about \$702 million over the twelve months ending June 30, 2016. As of that date, the market value of the account was \$733 million, reflecting a net unrealized gain of about \$31 million. The portfolio returned about 4.59% over the twelve months ending June 30, 2016, despite the low interest rate environment that continues in the fixed-income market. The return of 4.59% outperformed the benchmark by 36 basis points over that past twelve months, and no "other than temporary impairment" of investments was recorded during the report year. The chart to the right reflects the portfolio's performance compared to the benchmark for the twelve months ending at the respective periods.

Net Operating Results and Administrative Expenses

As noted, the Facility has continued to experience net operating losses over the report year, and those losses have totaled \$126.7 million for the fiscal year to date as of June 30, 2016. As of that date, the members' equity stood at -\$196.5 million and consists of -\$154.8 million private passenger business and -\$41.7 million other than private passenger.

The Facility's administrative expenses totaled \$6.2 million during calendar year 2015, which represented a decrease of 5% from the prior year and approximately 95% of the approved budget for the respective period. The total administrative expenses of the Facility are comprised of the direct costs related to specific activities of the Facility as well as allocated expenses of the departments whose services are shared with the Rate Bureau and Insurance Guaranty Association. The table and chart on this page show a summary of the direct and allocated expenses for the prior two years and the first half of 2016. Overall, the administrative expenses have remained relatively stable and consistent over the past few years and are projected to be within budget once again for 2016.

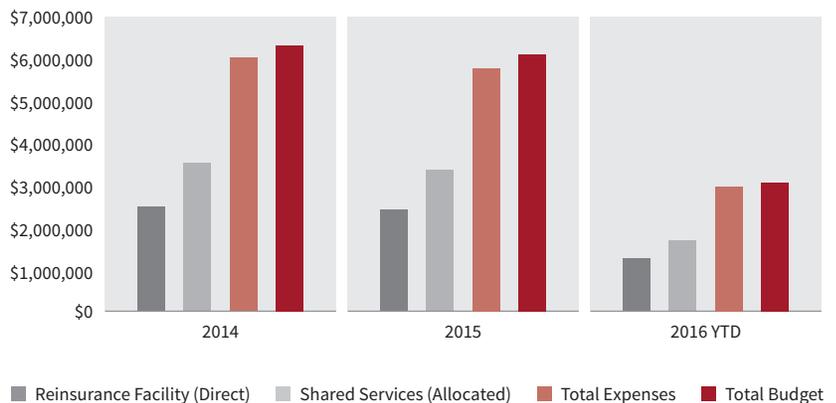
Audit

As previously reported, the Facility engaged the firm of Johnson Lambert to audit the financial statements beginning with the year ending September 30, 2015. The inaugural audit by the firm went well, and they presented their report to the Facility's Audit Committee in February 2016. Johnson Lambert issued a clean opinion on the Facility's audited financial statements and conducted the required communications to the Committee, noting no misstatements or internal control weaknesses identified during the audit, and that the significant accounting policies had been consistently applied during the current year. An excerpt of those audited financial statements is included in this report.

INVESTMENT PORTFOLIO PERFORMANCE
ANNUALIZED TOTAL RETURNS VS. BENCHMARK



ADMINISTRATIVE EXPENSES



| Administrative Expenses | 2014 | 2015 | Thru June 2016 |
|-------------------------------|---------------------|---------------------|---------------------|
| Reinsurance Facility (Direct) | \$ 2,680,383 | \$ 2,605,166 | \$ 1,367,547 |
| Shared Services (Allocated) | 3,794,489 | 3,607,415 | 1,811,776 |
| Total Expenses | \$ 6,474,872 | \$ 6,212,581 | \$ 3,179,323 |
| Total Budget | \$ 6,792,093 | \$ 6,560,842 | \$ 3,278,801 |

INFORMATION SERVICES



Shelley Chandler

CHIEF INFORMATION
OFFICER

As organizations become more dependent on data and systems to increase efficiency and effectiveness, Information Technology continues to grow in breadth and depth to help our organizations streamline operations while continuing to expand the focus on the security of the data and systems that are at the core. The North Carolina Reinsurance Facility, like all companies, continues to increase focus on strengthening the external perimeter to the data while ensuring that all assets are safe inside. After many years of working on external security from multiple

angles, in 2016 we turned some of our attention internally to ensure that our associates were educated about how to keep our organizations safe by not letting the bad guys into the network, as well as how to handle sensitive data inside and outside of the organization. The Facility updated our security policies on how our electronic assets can be used and protected and also implemented a suite of interactive training modules and awareness materials to help associates understand security threats and implement best practices. The benefits of a security education and awareness-training program include reduced malware infections, reduced successful phishing attacks, increased reporting of incidents by associates and an overall improved security posture. We also implemented and educated users on the use of encrypted email when transmitting sensitive data to recipients outside our organization.

Additional security improvements focused around another top security priority for 2016, improving our patch management program. We continued to focus our attention on patching and updating all off-the-shelf software in our inventory as a defense against the rise of widespread malicious code targeting known vulnerabilities on unpatched software and systems.

Our efforts to continually improve the EDGE system to be more effective and efficient for all users this year included re-engineering EDGE to allow for clean risk and loss recoupments to be reported on a combined basis.

Information Technology continues to look into the future to best utilize new technologies that enable efficiencies while focusing on the importance of securing the large volumes of data that are entrusted to us.

HUMAN RESOURCES



Vicki Godbold

CHIEF HUMAN RESOURCES
OFFICER

Our Human Resources is the strategic and comprehensive approach committed to our Organization's most valued assets—our people. Facility Services provide a secure and comfortable work environment along with mail services and receptionist services. One large initiative in HR the past year has been implementing Performance Evaluations based on each associate's job description. This is effective for 2016. In Facility Services, we upgraded our security through new software and two indoor cameras earlier this year.

Our Wellness Program consists of:

- WeightWatchers at work
- a partnership with WakeMed Hospital
- a partnership with the Performance Athletic Center (EXOS)
- a partnership with the NC Prevention Partners
- annual participation in the Wellness Council of America's (WELCOA) Step-By-Step program of walking 10k steps a day
- flu shots provided for associates on-site, and
- Certification in First Aid, CPR and AED for a third of our workforce through the American Red Cross

On-site training this year consisted of on-site fitness classes, wellness seminars and wellness lunch-n-learns by EXOS staff. Classes on personal shopping savings were also offered.

Community Service involvement by our associates this year included the SPCA, the United Way and the NC Food Bank.

NCRF MANAGEMENT STAFF



Tim Lucas
MANAGER, AUTOMOBILE



Mike Newton
MANAGER, CLAIMS



Jannet Barnes
MANAGER, COMPLIANCE

NORTH CAROLINA REINSURANCE FACILITY

Balance Sheet

| As of | June 30, 2016 | June 30, 2015 |
|--|-----------------------|-----------------------|
| Assets | | |
| Cash (Checking Account) | \$ 6,167,735 | \$ 8,670,696 |
| Cash Restricted (Including Escrow) | - | - |
| Investments | 702,167,090 | 770,181,765 |
| Accounts Receivable | 10,983,633 | 13,661,269 |
| Accrued Interest Receivable | 4,278,740 | 4,646,825 |
| Other Assets | 92 | 92 |
| Total Assets | \$ 723,597,290 | \$ 797,160,647 |
| Liabilities & Members' Equity | | |
| Accounts Payable | \$ 46,848,802 | \$ 30,069,384 |
| Loss Reserves | 576,504,395 | 523,471,320 |
| Unearned Premium Reserves | 296,484,954 | 277,714,076 |
| Provision for Premium Refunds | - | - |
| Other Liabilities | 299,422 | 811,834 |
| Total Liabilities | \$ 920,137,573 | \$ 832,066,614 |
| Members' Equity | (196,540,283) | (34,905,967) |
| Total Liabilities & Members' Equity | \$ 723,597,290 | \$ 797,160,647 |

Income Statement

| Fiscal Year through | June 30, 2016 | June 30, 2015 |
|--|-------------------------|------------------------|
| Income | | |
| Earned Premiums | \$ 701,458,876 | \$ 661,064,701 |
| Clean Risk Recoupment | 101,542,311 | 116,673,133 |
| Investment Income | 17,681,379 | 19,070,674 |
| Membership Fee Income | 54,200 | 53,800 |
| Other Income | 86,120 | 44,880 |
| Total Income | \$ 820,822,886 | \$ 796,907,188 |
| Expenses | | |
| Losses Incurred | \$ 681,054,381 | \$ 585,201,763 |
| Ceding & Claims Expenses | 262,001,931 | 256,286,982 |
| Premiums Escrowed | - | - |
| Other Underwriting Deductions | (299,168) | 201,875 |
| Salaries & Administration Expenses | 1,744,059 | 1,716,116 |
| Outside Services Expenses | 1,628,761 | 1,787,753 |
| Other Operating Expenses | 1,367,085 | 1,317,271 |
| Total Expenses | \$ 947,497,049 | \$ 846,511,760 |
| Net Income / (Loss) Before Loss Recoupments | \$ (126,674,163) | \$ (49,604,572) |
| Loss Recoupments | (664) | 587 |
| Net Income / (Loss) After Loss Recoupments | \$ (126,674,827) | \$ (49,603,985) |

NORTH CAROLINA REINSURANCE FACILITY

Special Purpose Balance Sheet

| Year Ending | Sept 30, 2015 | Sept 30, 2014 |
|--|-----------------------|-----------------------|
| Assets | | |
| Cash and Short-Term Investments | \$ 64,372,002 | \$ 19,402,063 |
| Investments, at Amortized Cost | 697,811,303 | 760,015,968 |
| Accrued Interest Receivable | 4,630,252 | 4,537,952 |
| Settlements Receivable From Member Companies: | 17,176,167 | 19,376,991 |
| Total Assets | \$ 783,989,724 | \$ 803,332,974 |
| Liabilities & Members' Equity | | |
| Loss and Loss Adjustment Expense Reserves | | |
| • In Course of Settlement | \$ 424,562,662 | \$ 395,102,656 |
| • Incurred But Not Reported | 116,822,367 | 109,536,163 |
| Total Loss and Loss Adjustment Expense Reserves | 541,385,029 | 504,638,819 |
| Unearned Premium Reserves | 290,883,240 | 265,432,835 |
| Advance Clean Risk Subsidies | 2,073,809 | 2,965,916 |
| Premium deficiency reserve | 299,168 | - |
| Settlements Payable to Member Companies | 20,858,188 | 18,278,399 |
| Other Liabilities | 429,554 | 284,903 |
| Total Liabilities | 855,928,988 | 791,600,872 |
| Members' Equity | (71,939,264) | 11,732,102 |
| Total Liabilities and Members' Equity | \$ 783,989,724 | \$ 803,332,974 |

Special Purpose Statement of Operations

| Year Ending | Sept 30, 2015 | Sept 30, 2014 |
|--------------------------------------|------------------------|------------------------|
| Premiums Earned | \$ 889,880,145 | \$ 845,732,308 |
| Clean Risk Subsidies | 159,320,049 | 111,256,490 |
| Total Underwriting Income | 1,049,200,194 | 956,988,798 |
| Losses Incurred | 802,600,646 | 702,054,308 |
| Ceding Expense Allowances | 238,959,101 | 217,979,401 |
| Claims Expense Allowances | 109,295,610 | 99,539,773 |
| Change in premium deficiency reserve | 299,168 | - |
| Total Underwriting Expenses | 1,151,154,525 | 1,019,573,482 |
| Net Underwriting Loss | (101,954,331) | (62,584,684) |
| Other Income (Expense) | | |
| Net Investment Income | 20,296,014 | 22,573,517 |
| Net Realized Investment Gains | 3,131,336 | 5,349,937 |
| Late Premium Charges and Penalties | 73,616 | 140,609 |
| Membership Fees | 53,800 | 54,900 |
| General and Administrative Expense | (5,272,382) | (5,535,657) |
| Other Miscellaneous Income | - | 4,802 |
| Total Other Income – Net | 18,282,384 | 22,588,108 |
| Net Operating Loss | \$ (83,671,947) | \$ (39,996,576) |

NCRF

NORTH CAROLINA
REINSURANCE FACILITY

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